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BANKING IN CANADA.

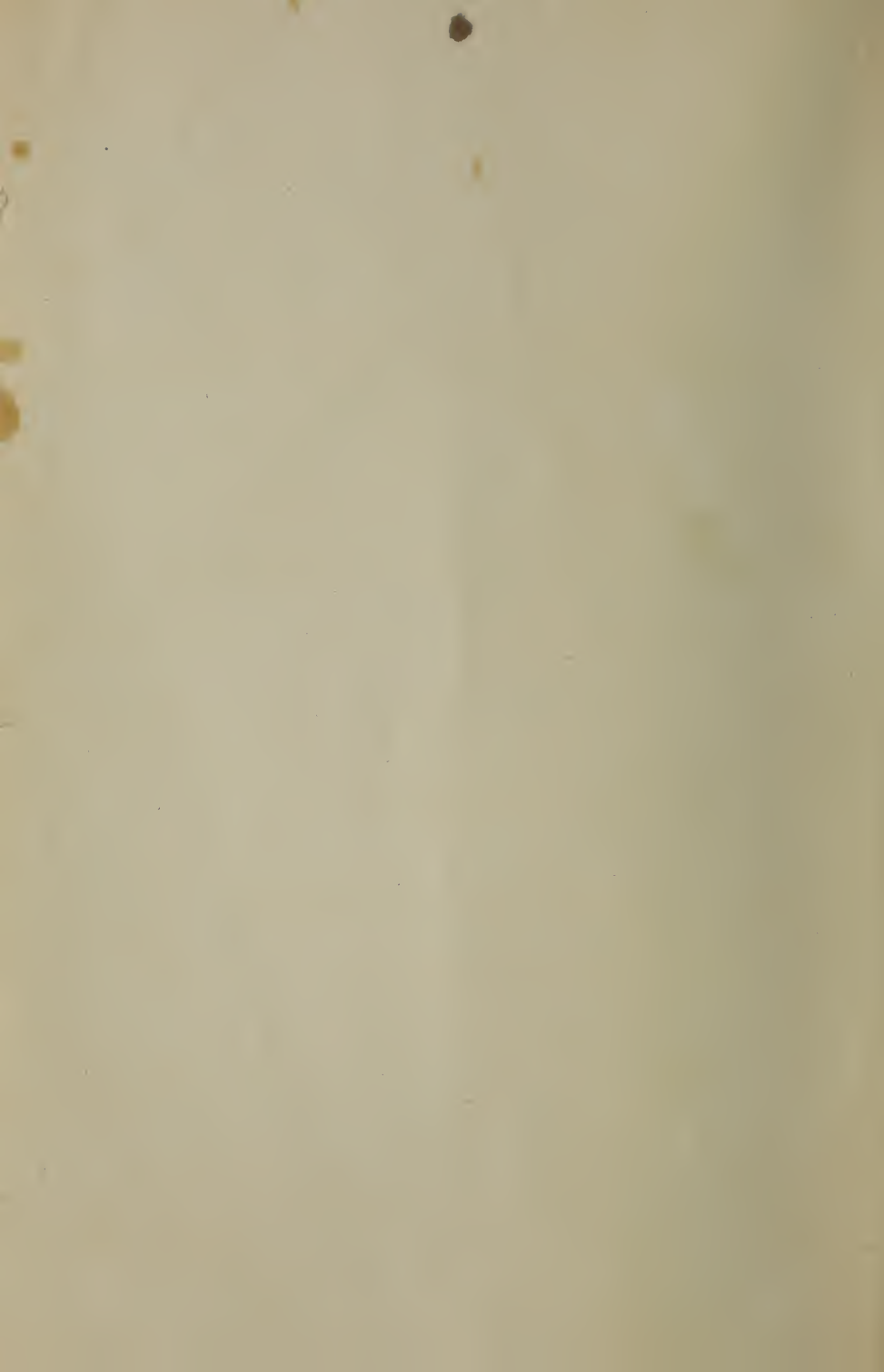
PAPER READ BEFORE THE CONGRESS OF BANKERS
AND FINANCIERS, CHICAGO, 23RD JUNE, 1893.

BY B. E. WALKER,

GENERAL MANAGER

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IN common with other social developments, modern banking is mainly the result of heredity and environment, and not of arbitrary legislation or the general admission in any wide degree of settled principles in the practice of banking. The student endeavoring to understand the science of banking, seeking to discover some body of principles underlying the practice of banking throughout the world, is confused by the radical differences between the systems of the various nations and the complicated nature of the conditions surrounding each of these systems. The most cherished dogma of one country is rank heresy in another. The principles suitable to an old country, with a compact population, a highly developed railroad and telegraph organization for the distribution of commodities and information, and wealth enough to be lenders to other nations, are not applicable to a new country with a scattered population, imperfect means of distribution, and little wealth apart from fixed property—a country, indeed, requiring to borrow largely from older and wealthier communities.

Again, if in any country banking has been left to develop itself in accordance alone with the requirements of trade, or nearly so, that country has been fortunate in this respect as compared with others, where the national debt, caused by war or extravagances in public works, has been made the basis of the

currency. Sometimes, however, the condition of the present environment in two countries may be in many respects similar, and yet a practice in banking which has worked out desirable results in one of these countries cannot be attempted in the other. The body of banking principles in the other country may be so different, because of hereditary influences, as to make it impossible by any kind of evolution to add the practice which has proved so serviceable elsewhere.

I am aware that there is nothing new in this point of view, but in attempting to speak on the subject of banking in Canada, I cannot avoid comparison with this great country where banking systems are being keenly discussed, and where it is admitted that changes, perhaps of a radical nature, are necessary. In contending for the comparative perfection of the Canadian system I do not wish to be understood as asserting that the points of superiority in our system could be adopted here. For over half a century banking in the United States has been following lines of development opposed in many respects to the Canadian system, and it may well be that no matter how desirable, it is too late to adopt our practices.

My main object, however, is to describe the banking of Canada, and to demonstrate, if I can, its suitability to the requirements of trade in that country and not its suitability elsewhere.

BANK CHARTERS.

It has been occasionally urged by writers in financial journals published in the United States, that banking in Canada is a monopoly, and therefore unsuited to the democratic principles of this country. These writers have overlooked the fact that the Province of Ontario, the centre of thought and progress in the Dominion, is the most democratic community in the British Empire, and that the legislation of Canada, whether in form or not, is in reality as liberal as it can well be. Banking in Canada is not in any sense a monopoly. Whether it can be said to be "free banking" as understood in the United States, depends on what is meant by that term. In the United States a certain number of individuals having complied with certain requirements—more numerous and complicated, by the way, than the Canadian requirements—become thereby an incorporated bank, if we regard the consent of the Comptroller of Currency as a matter of form. In Canada, merely in order to follow the British parliamentary methods, when a certain number of individuals have complied with certain requirements, they are supposed to have applied

for a charter, which parliament theoretically might refuse, but which, as a matter of fact, would not be refused unless doubt existed as to the bona fide character of the proposed bank. Then, as in the United States, on complying with certain other requirements and obtaining consent of the Treasury Board (performing in this case the same function as the Comptroller of Currency in the United States), the bank is ready for business.

The main difference in the matter of obtaining the privilege from the people to carry on the business of banking is that in Canada the subscribed capital must be \$500,000, paid up to the extent of one-half, or \$250,000, and this fact must be proved by the temporary deposit of the actual money with the Treasury Department. If it is contended that a monopolistic element is introduced by making the minimum paid-up capital \$250,000, I have only to point to the varying minima of capital in the National banking system, based upon the population of the city or town where a bank is established. The minimum with us is placed so high because with the privilege to carry on the business of banking is attached the privilege to open branches and to issue a bank note currency not secured by special pledge with the government. In the opinion of many Canadians the minimum is too small. So much for the statement that banking is less "free" in Canada than in the United States. I think the very term "free banking," about which so much was written in the antebellum days, is a misnomer; and I hope there are many here who agree with me that a little less of freedom in the ability to create a bank, and a little more knowledge on the part of the people regarding the true function of banking, and its high place in the world of commerce, would be for the public good. What we want is the most absolute evidence, when a bank is created, that its projectors are embarking in a bona fide venture and have put at risk a sum considerable enough to ensure that fact.

In Canada, as in the United States, shareholders in banks are subject to what is known as "double liability." For the benefit of any of my hearers who may not understand the phrase, I will quote the section in full:—"In the event of the property and assets of the bank being insufficient to pay its debts and liabilities, each shareholder of the bank shall be liable for the deficiency to an amount equal to the par value of the shares held by him, in addition to any amount not paid up on such shares."—(Sec. 89). I can remember when the practical value of this power to call on the shareholders in the event of the failure of a bank for

a second payment to the extent of the subscribed amount of the shares was doubted by many. Shares were transferred just before failure to men unable to meet such calls and willing to be used in this manner, or shares were found to be held by men of straw who owed a corresponding amount to the bank. Or, again, many of the shareholders were borrowers for amounts far in excess of their holdings in shares, and the failure of the bank precipitated their failure as well, and they were thus unable to pay. Of course there were always some real investors among the shareholders, but the value of the double liability was a very variable and doubtful quantity. These features have not, as we know, all passed away, but we have done as much as we could to guarantee an honest share list and to prevent the shareholder from escaping his liability. Banks are not allowed to lend money on their own or the stock of any other Canadian bank, and as the minimum paid-up capital of \$250,000 must be deposited with the Finance Department before a bank commences business, this should ensure a bona fide capital at the start. All transfers of shares must be accepted by the transferee. No transfers within 60 days before failure avoid the double liability of the transferor unless the transferee is able to pay. A list of the shareholders in all banks is published annually by the government, and this book is eagerly examined by investors to ascertain changes in the share list of banks which might indicate distrust. As the capital of each bank is large and the number of banks small relatively to the United States, there is, regarding everything connected with the credit of a Canadian bank, an amount of public scrutiny which leads to circumspection in the conduct of bank authorities. Again, the very fact that the capital is large and that the banks have many branches and a more or less national character, causes the stock to be widely held. In the largest banks the share list numbers from 1,800 to 2,000 names. We still, doubtless, have plenty of bad banking and will always have it. No legislative checks will prevent that, and even a severe public scrutiny will not altogether prevent it; but our banking history since the Confederation of the old provinces into the Dominion in 1867, shows that the double liability has been a most substantial asset, and has done much towards enabling liquidated banks to pay in full. In my own province of Ontario we have the fine record of no instance, save one, since Confederation in 1867, in which all creditors have not been paid in full.

In the case of this one blemish the dividends amounted to 99½ cents to depositors, only the unwarrantably high fees paid to the liquidators causing the dividend to fall below 100 cents. In the short life of this institution almost every sin in the calendar of banking had been committed.



TERM OF THE CHARTER.

Under the United States National Banking system the life of a bank is limited to twenty years from the date of the execution of the particular bank's certificate of organization, but at the expiration of the first, or any succeeding period, the bank, if it elects to do so, may have its corporate existence renewed for the same number of years. Under the Canadian system the charter of every bank expires at the same time, and the renewal period is only ten years. I do not intend to discuss the length of the period—most of us think it quite too short. It is the effect of all charters expiring at the same time to which I desire to draw your attention. This condition of things doubtless arose merely from the confederation in 1867 of the provinces which had granted the then existing charters, but which thereupon surrendered their authority over banking institutions to the Federal Government. As the charters granted by the old provinces expired, the banks working under them became institutions subject to the new Federal or Dominion Banking Act, and by its conditions every charter expires at the same time. This ensures a complete discussion of the principles underlying the Act, and of the details connected with the working of it, once in ten years. In the interval we are almost free from attempts by demagogues or ambitious but ill-informed legislators to interfere with the details of our system, but during the session of Parliament preceding the date of the expiry of the charters we have to defend our system from the demagogue, the bank-hater, the honest but inexperienced citizen who writes letters to the press, sometimes the press itself—indeed from all the sources of attack which institutions possessing a franchise granted by the people experience when they come before the public to answer for their stewardship. But while resisting the attacks of ignorance, we are, of course, called upon to answer such just criticism as may arise from the existence of defects in our system developed by the experiences of time. Or perhaps, as when the Act was under discussion in 1890, we may see the defects even more clearly than the public, and may ourselves suggest the remedies. Whatever may be said for or against these decennial battles, the product of the discussion is a

Banking Act, improved in many respects by the exchange of opinion between the bankers and the public. The banking system having been subjected to unsparing analysis by an unusually enlightened people—perhaps too democratic in tendency and too jealous of every privilege granted, but anxious to build rather than to destroy—is brought at each period of renewal to a higher degree of perfection.

BANKING PRINCIPLES.

What is necessary in a banking system in order that it may answer the requirements of a rapidly growing country and yet be safe and profitable?

1. It should create a currency free from doubt as to value, readily convertible into specie, and answering in volume to the requirements of trade. In saying this I do not wish to be understood as asserting that banks should necessarily enjoy the right to issue notes. Whether they should or should not issue notes must always, I presume, end in a discussion as to expediency in the particular country or banking system.

2. It should possess the machinery necessary to distribute money over the whole area of the country, so that the smallest possible inequalities in the rate of interest will result.

3. It should supply the legitimate wants of the borrower, not merely under ordinary circumstances, but in times of financial stress, at least without that curtailment which leads to abnormal rates of interest and to failures.

4. It should afford the greatest possible measure of safety to the depositor.

We think in Canada that our system possesses all these qualities, and we are confident that we have a currency perfectly suited to our trade and other requirements. We have not, however, arrived at our present reasonably comfortable condition by any other process than the usual slow development from a past full enough of error and bitter experience.

HISTORICAL SKETCH.

It is perhaps not generally known that we were among the first in modern times to issue *fiat* paper-money for general circulation. In 1685, in the time of the French regime in Canada, the Intendant could not pay his soldiers. The little struggling colony, after the manner of all new countries, was an absorbent of money, and France was nearly bankrupt and could afford no aid. So the Intendant, left to his wits alone and having a helpless people

to deal with, cut playing cards into small pieces, wrote thereon his promises to pay, accompanied by the seal of France, and thus led the way in North America in this seductive method of paying debts. For the next thirty years this was the money of Canada. Although always written, because the people would not have accepted printed promises to pay, the volume rose to about \$20 per head, when the usual results of *fiat* money followed. It was compromised, and the Government promised never to repeat the experiment. The poor colony, left with no regular currency, struggled for a time, but in 1729, at the request of the people, card money was issued again. They had now some experience, but did not understand how to draw lessons from it, and the amount issued was so excessive that when the British took Quebec, and assumed the government of Canada, one of the most troublesome features in the settlement with France was the arrangement for the retirement of this currency. It would have been well if this complete exposition, although on such a small scale, of the unsoundness of *fiat* money, had served for all North America. Mr. Sumner says there was a bank in Massachusetts as early as 1686 which may have issued notes, but there is a story in this connection so picturesque that I hope it is true. A couple of Massachusetts fur traders are supposed to have visited Canada a few years after the card money first appeared, and to have reported at home the prosperity resulting from the experiment, and so when the military expedition against Canada was organized in 1690, what more natural than that Massachusetts should have paid the cost in the first of that currency, which in its final stages of collapse has given our language that expressive phrase, "not worth a continental"? We were even smaller, relatively, in population then than we are now, yet apparently you did not hesitate to adopt a very bad feature in our development. If we have anything to-day in our financial conditions worth your attention, I hope it will not the less merit your approval because the development is on such a small scale. Sound or unsound principles are perhaps more easily detected when a system has not become complicated beyond the capacity for analysis of the ordinary individual.

I will now, in as few words as possible, finish the historical sketch which is necessary to the clear understanding of our currency and banking as it exists at present. Shortly after you organized a bank in Philadelphia in 1781 and another in New York in 1784, the merchants of Quebec and Montreal began to agitate for a bank of issue. In those days a bank without the power to

issue notes was of little use; but the people of Canada having very strong opinions on this subject, the attempt was a failure, although in 1792 a private bank of deposit resulted. The merchants tried again with the same result in 1807-8. But during the war of 1812 the Government found it necessary to issue some kind of paper money, and an Army Bill Office was created. These were the first paper notes put in circulation in Canada under British authority, and as they were paid in full, the people must have been at last convinced that all paper money was not bad. In the Province of Nova Scotia, not then joined with us in the Dominion of Canada as it is now, Treasury notes were also issued in 1812. At the same time banking was growing rapidly in Great Britain and the United States, and in 1817 our first joint stock bank was created—that great institution of which we are all so proud, and which I am sure has done its share in making Chicago what it is to-day—the Bank of Montreal.

From 1817 to 1825, two banks were established in Lower Canada (Quebec), and one each in Upper Canada (Ontario), New Brunswick, and Nova Scotia, all now doing business except one.

I will not attempt to follow the course of banking in the old provinces, but it is necessary to indicate the condition of banking and currency at the time of the Confederation of the provinces into the Dominion of Canada in 1867. There were thirty-nine charters, but only twenty-seven banks doing business. The charters expired at various dates from 1870 to 1892, and varied in accordance with the views regarding banking in the different provinces. In Upper and Lower Canada (Old Canada), shareholders were liable for double the amount of their stock, except that there was one bank *en commandite*, the "principal partners" having unlimited personal liability. In most cases notes could be issued equal to the paid-up capital *plus* specie and Government securities held. In New Brunswick charters had been granted without the double liability, but the principle was being insisted on in renewals, while in Nova Scotia in the opinion of some there was no double liability. In Old Canada and Nova Scotia, as a rule, total liabilities were restricted to three times, and in New Brunswick to twice the amount of capital. There was also one bank with a royal charter, head office in England, and shareholders not under double liability. The situation was further complicated by the "Free Banking Act," under which notes could be issued secured by deposit of Government debentures, and by the legal tender issues of the Governments

of Old Canada and Nova Scotia. In 1866-67 two of the largest banks in Upper Canada failed, resulting in a very severe financial crisis.

Under these conditions, and after tentative legislation in 1867 and 1870, the first general Bank Act of the Dominion was passed in 1871 (34 Vict. c. v.). It confirmed the special features in the bank working under a royal charter, and that with "principal partners" personally liable, and it will be understood in any statements hereafter regarding banks as a whole that these institutions are not referred to. As the charters of other banks expired they were renewed under the Dominion Act. The first Act extended all charters for ten years, which practice has been followed thus far. There were various amendments during the first few years, but since then changes have been infrequent, except at the regular revisions in 1880 and 1890. The Act hereafter referred to is that assented to May, 1890, and which came into force July, 1891. (53 Vict. c. xxxi.).

NOTE ISSUES.

In the successive Banking Acts of the Dominion Parliament banks have been empowered to issue circulating notes to the extent of the unimpaired paid-up capital. By the first Act the note-holders had no greater security than the depositors and other creditors. At the renewal of charters in 1880, the circulating note was made a prior lien upon all assets; and at the last renewal in 1890 the banks, at their own suggestion, were in addition required to create in two years a guarantee fund of 5 per cent. upon their circulation, to be kept unimpaired, the annual contribution, however, if the fund is depleted, to be limited to 1 per cent. The fund is to be used whenever the liquidator of a failed bank is unable to redeem note issues in full after a lapse of sixty days. Notes of insolvent banks are to bear 6 per cent. interest from the date of suspension, until the liquidator announces his ability to redeem. Banks are also required to make arrangements for the redemption at par of their notes in the chief commercial cities in each of the provinces of the Dominion. The change in 1880 was caused by the failure of a small bank with a circulation of about \$125,000, paying all creditors, note holders included, only 57½ per cent. The change in the Act now in force was due to the demand for a currency which would pass over the entire Dominion without discount under any circumstances. The history of banking in Canada since Confederation shows no instance in which a depletion of such a

guarantee fund would have occurred. Fines from \$1,000 to \$100,000 may be imposed for the over-issue of notes. The pledging of notes as security for a debt, or the fraudulent issue of notes in any shape, renders all parties participating liable to fine and imprisonment. As the crown prerogative to pay in priority to other creditors had been set up on behalf of both Dominion and Provincial Governments, the Act places the claims of the Dominion second to the note issues, and those of the provinces third. Notes of a lesser denomination than \$5 may not be issued, and all notes must be multiples of \$5. Notes smaller than \$5 are issued by the Dominion Government.

The distinctive features, therefore, of our bank note issues are:—

(a) They are not secured by the pledge or special deposit with the Government of bonds or other securities, but are simply credit instruments based upon the general assets of the bank issuing them.

(b) But in order that they may be not less secure than notes issued against bonds deposited with the Government, they are made a first charge upon the assets.

(c) To avoid discount for geographical reasons each bank is obliged to arrange for the redemption of its notes in the commercial centres throughout the Dominion.

(d) And, finally, to avoid discount at the moment of the suspension of a bank, either because of delay in payment of note issues by the liquidator or of doubt as to ultimate payment, each bank is obliged to keep in the hands of the Government a deposit equal to five per cent. on its average circulation, the average being taken from the maximum circulation of each bank in each month of the year. This is called the Bank Circulation Redemption Fund, and should any liquidator fail to redeem the note of a failed bank, recourse may be had to the entire fund if necessary. As a matter of fact, liquidators almost invariably are able to redeem the note issues as they are presented, but in order that all solvent banks may accept without loss the notes of an insolvent bank, these notes bear six per cent. interest from the date of suspension to the date of the liquidator's announcement that he is ready to redeem.

I have already stated, in attempting to outline what is necessary in a banking system in order that it may answer the requirements of a rapidly growing country, that "it should create a

currency free from doubt as to value, readily convertible into specie and answering in volume to the requirements of trade." In an admirable paper on "The Note Circulation" read in December, 1889, before the Institute of Bankers, in London, England, by MR. INGLIS PALGRAVE, only two requisites in a note circulation are directly stated as essential: "First, that it should be completely secured. Second, that it should be readily convertible into metallic money." But the discussion which follows bears directly upon a third requisite, that it should answer in volume to the fluctuating requirements of trade, in a word that it should be elastic. This last is a much less important point, however, in England, than in North America.

In discussing bank issues I will reverse the order in which the three requirements are placed in MR. PALGRAVE's paper and the ensuing discussion, and take up the question of elasticity first. I shall not attempt to discuss the many and conflicting views held regarding paper money, its use and abuse, and whether there is any scientific basis for its issue; but I shall endeavor to show to what extent it seems possible for note issues in North America to have a scientific basis with regard to elasticity. In Canada, as in the United States, the resulting difference in business transactions, after cheques and all other modern instruments of credit have been used, is almost entirely paid in paper money. It is therefore of the greatest importance that the amount of this paper money existing at any one time, shall be as nearly as possible just sufficient for the purpose. That is, that there shall be a power to issue such money when it is required, and also a power which forces it back for redemption when it is not required.

I may, therefore, I think, safely lay it down as a principle that: (1) There should be as complete a relation as possible between the currency requirements of trade and whatever are the causes which bring about the issue of paper money; (2) and, as it is quite as necessary that no over-issue should be possible, as that the supply of currency should be adequate, there should be a similar relation between the requirements of trade and the causes which *force notes back* for redemption.

Now, certainly, one of the *causes* of the issue of bank notes is the profit to be derived therefrom, and it is clear that an amount sufficient for the needs of trade will not be issued unless it is

profitable to issue. Likewise it is clear that it should not be possible to keep notes out for the sake of the profit if they are not needed.

In Canada, bank notes, as we have seen, are secured by a first lien upon the entire assets of the bank, including the double liability, the security being general and not special—not by the deposit of Government Bonds, for instance. Therefore it is clear that it will always pay Canadian banks to issue currency when trade demands it. Because bank notes in Canada are issued against the general estate of the bank, they are subject to daily *actual* redemption; and no bank dares to issue notes without reference to its power to redeem, any more than a solvent merchant dares to give promissory notes without reference to his ability to pay. The presentation for actual redemption of every note not required for purposes of trade, is assured by the fact that every bank seeks by the activity of its own business to keep out its own notes, and therefore sends back daily for redemption the notes of all other banks. This great feature in our system as compared with the National Banking System, is generally overlooked, but it is because of this daily actual redemption that we have never had any serious inflation of our currency, if indeed there has ever been any inflation at all. Trade, of course, becomes inflated, and the currency will follow trade, but that is a very different thing from the existence in a country of a great volume of paper money not required by trade. I will not discuss at length this quality of elasticity in our system, because it is generally admitted. But some critic may endeavor to show that a similar quality might be given to a currency secured by Government bonds, and I desire to make it clear that such elasticity as is required in North America is impossible with a currency secured by Government bonds. In the older countries of the world it may be sufficient if the volume of currency rises and falls with the general course of trade over a series of years, and without reference to the fluctuations within the twelve months of the year. In North America it is not enough that the volume of currency should rise and fall from year to year. In Canada we find that between the low average of the circulation during about eight months of each year and the maximum attained at the busiest period of the autumn and winter, there is a difference of twenty per cent., the movement upward in the autumn and downward in the spring being so sudden that without the power in the banks to issue, in the autumn serious stringency must result, and without the force which brings about redemption in the spring there must be plethora. As a matter of fact it works automatically, and there is always enough and never too much.

If our currency were secured by Government bonds the volume in existence at any one time would be determined by the profit to be gained by the issue of such bond-secured currency. It would, therefore, be necessary to fix a maximum beyond which no currency could be issued, but as such an arbitrary limit would be mere legislative guess work, it would be productive of the evils incident to all efforts to curb natural laws by legislation. As we all know, when the National Bank charters were offered by the Federal Government to the State Banks, the bonds of the United States bore 5 to 6 per cent. interest, and the business of issuing currency against such bonds was so profitable that a maximum such as I have referred to was fixed, with an elaborate provision stating how the banking charters were to be distributed as to area, in order that each State or section of country might have a fair share. This was followed by several adjustments, the last limit being \$354,000,000, no one being satisfied with the interference with free banking, and the cry of monopoly being frequently heard. Subsequently the maximum was abandoned; indeed the business of issuing notes against Government bonds had become unprofitable and there was no longer any fear of inflation.

The condition in the United States under which the issue of currency was unduly profitable, and the fear of inflation was present, did not actually last many years, but it lasted long enough to create in the people a hatred of banks which does not seem yet to have quite passed away. The condition which followed showed, it seems to me, conclusively the unsoundness of the system in the matter of providing an elastic currency, a currency *at all times* adequate in volume. The currency wants of the country increased with the great increase in population, but the volume of National Bank currency decreased because by the repayment of the national debt and the improvement in the national credit the bonds which remained outstanding yielded so low a rate of interest as to make the issue of National Bank notes unprofitable. The Comptroller's statement shows that the volume of circulation secured by United States bonds, which ranged from 1866 to about 1880 at from about \$300,000,000 to \$350,000,000, has declined until the amount subject to redemption by the banks is now only about \$130,000,000. The moral of this is plain. If the Government bond yields such a low rate of interest as to make it unprofitable to issue currency, banks will not provide sufficient currency for the wants of the country. I need not remind an American audience

that it was this unfortunate contraction which to a great degree made it possible for the Bland Act silver issues, from 1878 to 1890, to create so little financial disturbance.

I hope I have made it clear that if the business of issuing currency against Government bonds were profitable, too much currency would be the result ; and if it were unprofitable, too little would be issued. We would require to have a condition of things under which the profit of issuing notes would at all times bear an exact relation to the amount of currency required by the country, the profit therefore changing not only as the currency rises and falls over a series of years, but at the time of the sharp fluctuations within each year, already referred to. No such relation, however, could very well exist with an issue based upon Government bonds.

The next quality in a currency to be considered is, " That it should be readily convertible into metallic money." I do not propose to discuss this at length. As I have pointed out, our safety lies in the actual daily redemption which arises out of our circulation being generally instead of specially secured. This is the best possible safeguard against suspension of specie payments. The United States National Banking System was created during a suspension of specie payments, and doubtless would never have been heard of but for that fact.

My last point is that placed first by MR. PALGRAVE in his discussion with the English bankers : " That the currency should be completely secured." I do not know whether we are to understand also that a note must pass throughout the entire country without discount for any reason, but I include that in the point to be discussed. Now, I contend that it is better for the reasons given, that bank issues should be based for security on the general assets of the bank, with a prior lien to other creditors ; and also, that taking the world as a whole, such notes will be actually safer because the effect of a system of notes secured by Government bonds—a loan forced by the Government, practically—must sometimes be to produce national bankruptcy, as in the case of the Argentine Republic. Still, I cheerfully admit that the United States National Banking System has taught us that a currency issued by banks may be made to pass over the entire area of a great nation without discount. This is a great quality in currency. To the ordinary individual, who knows and cares little about banking except as it affects the bank note he happens to carry in his pocket, it appears to be the one quality necessary.

In Canada, experience has shown that as long as the notes are a prior lien on the assets of the bank, including the double liability, ultimate loss is scarcely possible,—has not at all events occurred as yet. To secure a circulation—at the close of December, 1892, of \$36,194,023—the banks had assets of \$305,730,910, to which the double liability of \$63,169,643 is to be added, making a total of \$368,900,553 or \$10.19 of assets against every dollar of currency. It has been pointed out, however, that the assets are not thus aggregated against the circulation, and that all banks are not as secure as these figures seem to show. But the security in this respect, in regard to each bank, varies little from the general average, the lowest percentage being 6.18 as against the general average of 10.19. The lowest percentage applies to but two or three small banks, none others falling below about \$8 for every dollar of circulation. To this we have added the five per cent. guarantee fund applicable in its entirety to meet the notes of any individual bank.

THE BORROWER AND THE BRANCH SYSTEM.

In discussing the banking systems in older countries, the borrower is not often considered. Men must borrow where and how they can, and pay as much or as little for the money as circumstances require. I believe too strongly in the necessity for an absolute performance of engagements, to think that it is a requirement in any banking system that it shall make the path of the debtor easy. Every banker should discourage debt, and keep before the borrower the fact that he who borrows must pay or go to the wall. But in America the debtor class is apt to make itself heard, and I wish to show what our branch system does for the worthy borrower as compared with the United States National Banking System.

In a country where the money accumulated each year by the people's savings does not exceed the money required for new business ventures, it is plain that the system of banking which most completely gathers up these savings and places them at the disposal of the borrowers, is the best. It is to be remembered that this involves the savings of one slow-going community being applied to another community where the enterprise is out of proportion to the money at command in that locality. Now, in Canada, with its banks with forty and fifty branches, we see the deposits of the saving communities applied directly to the country's new enterprises in a manner nearly perfect. The Bank of Montreal

borrow money from depositors at Halifax and many points in the Maritime Provinces, where the savings largely exceed the new enterprises, and it lends money in Vancouver or in the North-west, where the new enterprises far exceed the people's savings. My own bank in the same manner gathers deposits in the quiet unenterprising parts of Ontario, and lends the money in the enterprising localities, the whole result being that forty or fifty business centres, in no case having an exact equilibrium of deposits and loans, are able to balance the excess or deficiency of capital, economizing every dollar, the depositor obtaining a fair rate of interest, and the borrower obtaining money at a lower rate than borrowers in any of the colonies of Great Britain, and a lower rate than in the United States, except in the very great cities in the East. So perfectly is this distribution of capital made, that as between the highest-class borrower in Montreal or Toronto, and the ordinary merchant in the North-west, the difference in interest paid is not more than one to two per cent.

In the United States, as we know, banks have no branches. There are banks in New York and the East seeking investment for their money, and refusing to allow any interest because there are not sufficient borrowers to take up their deposits ; and there are banks in the West and South which cannot begin to supply their borrowing customers, because they have only the money of the immediate locality at their command, and have no direct access to the money in the East, which is so eagerly seeking investment. To avoid a difficulty which would otherwise be unbearable, the western and southern banks sometimes re-discount their customers' notes with banks in the East, while many of their customers, not being able to rely on them for assistance, are forced to float paper through eastern note-brokers. But, of course, the western and southern banks wanting money, and the eastern banks having it, cannot come together by chance, and there is no machinery for bringing them together. So it follows that a Boston bank may be anxiously looking for investments at four or five per cent., while in some rich western state ten and even twelve per cent. is being paid. These are extreme cases, but I have quoted an extreme case in Canada, where the capital marches automatically across the continent to find the borrower, and the extra interest obtained scarcely pays the loss of time it would take to send it so far, were the machinery not so perfect.

As I have indicated, it should be the object of every country

to economize credit, to economize the money of the country so that every borrower with adequate security can be reached by some one able to lend, and the machinery for doing this has always been recognized in our banks. That is surely not a perfect system of banking under which the surplus money in every unenterprising community has a tendency to stay there, while the surplus money required by an enterprising community has to be sought at a distance. But if by paying a higher rate of interest, and seeking diligently, it could always be found, the position would not be so bad. The fact is that when it is most wanted, distrust is at its height, and the cautious eastern banker buttons up his pocket. When there is no inducement to avert trouble to a community by supplying its wants in time of financial stress, there is no inclination to do so. The individual banks, East or West, are not apt to have a very large sense of responsibility for the welfare of the country as a whole, or for any considerable portion of it. But the banks in Canada, with thirty, forty or fifty branches, with interests which it is no exaggeration to describe as national, cannot be idle or indifferent in time of trouble, cannot turn a deaf ear to the legitimate wants of the farmer in the prairie provinces, any more than to the wealthy merchant or manufacturer in the East. Their business is to gather up the wealth of a nation, not a town or city, and to supply the borrowing wants of a nation.

There was a time in Canada, about twenty years ago, when some people thought that in every town, a bank, no matter how small, provided it had no branches, and had its owners resident in the neighborhood, was a greater help to the town than the branch of a large and powerful bank. In those days, perhaps, the great banks were too autocratic, had not been taught by competition to respect fully the wants of each community. If this feeling ever existed to any extent, it has passed away. We are, in fact, in danger of the results of over-competition. I do not know any country in the world so well supplied with banking facilities as Canada. The branch system not only enables every town of 1,000 or 1,200 people to have a joint stock bank, but to have a bank with a power behind it generally twenty to fifty times greater than such a bank as is found in towns of similar size in the United States would have.

But one of the main features of the branch system is connected intimately with our power to issue notes based upon the general assets of the bank. When the statement of a large Canadian

bank is examined by an American banker, the comparatively small amount of actual cash must be noticeable. He will notice that the bank is careful to have large assets in the United States which may be taken back to Canada in times of financial strain there, and large assets in convertible shape at home, but having regard to actual cash as the machinery for carrying on the business at the counter, how can a bank with forty or fifty branches get along with so little cash? The simple answer is that the tills of our branches are filled with notes which are not money until they are issued, and which, therefore, save just that much idle capital and just that much loss of interest.

THE DEPOSITOR.

The legal position of the Depositor is about the same in both countries. The note-holder's claim is preferred to his. We must not, however, expect that any government will relieve a depositor from the necessity of using discretion as to where he places his money. Governments never have done and never can do that. Men must look around, and after measuring the security offered, judge where they should entrust their money. It is perhaps easier for a man with limited intelligence to make a selection if the banks have large capital and are of semi-national importance, provided, of course, the basis of the system is not unsound, as in Italy and Australia. In Canada, we do not borrow from abroad, although we would not object to do so if money could be obtained at low enough rates of interest; our banks have large capital and small deposits relatively, and we do not lend on real estate. The Government statement at 31st December, 1892, shows that before depositors having claims amounting to \$180,000,000 can suffer, shareholders must lose in paid-up stock and double liability as much as \$126,000,000, and \$25,000,000 of surplus funds, in all \$151,000,000. There is probably no country in the world where greater security is offered to depositors.

When our charters were under discussion two or three years ago, I had occasion to defend our system, and I have copied freely from a pamphlet written by me at that time. I must not, therefore, omit to repeat a statement made then, which might excite criticism more readily, now that the banking system of Australia has collapsed. In making a comparison between individual banks with small capital, and banks with branches and large capital, I urged that:—

“The probability of loss to the depositors in one bank

“with several millions of capital, is less than the probability of loss to *some* of the depositors in ten or twenty small banks, having *in the aggregate* the same capital and deposits as the large bank.”

The retort will be quickly made:—“But if the large bank fails, the ruin will be just so much the more widespread.”

This is quite true, but while it appears to be an answer to the point it is not. If the conditions of two countries are about the same and the ability of the bankers and the principles of the banking system, are in other respects equally excellent, it must still remain true that the *probability* of loss to the depositors in one or more of the ten or twenty small banks is greater than the *probability* of loss to any of the depositors in the one large bank.

There are some features in our deposit business which may be interesting to American bankers. There are perhaps not half a dozen savings banks, as the term is understood in North America, in the whole of Canada, and those only in the largest cities, and there is really little need for the existence of any. The Government carries on the Post Office Savings Bank system, copied in some respects from Great Britain. It is unnecessary and unsuited to our country, but it perhaps affords the very ignorant a refuge from the dread of bank failures. The safe-guards always necessary when a government undertakes to carry on a regular business are so many and so tedious that the leading banks do not find it necessary to allow as high a rate of interest as the Government.

In addition to the Government we have as competitors for deposits the companies authorized to lend on real estate. Most of those companies, however, now borrow only on debentures, at fixed periods. Some of this money is borrowed in Great Britain, but much of it is obtained at home. I may say here that while, as with you, banks have fortunately no power to lend on real estate, the restriction is perhaps no longer necessary, as land banking and mercantile banking are clearly separated in the minds of every intelligent man of business in Canada. And as the banks do not buy paper made for the purpose of obtaining money, as you do in the United States, but loan only to their own customers, supplying their entire wants, and seeing that the money is to make or move some product about to be sold, we do not so often discover that we have unwittingly been booming a corner lot, building a mill, or helping to float a company.

Returning from this digression to the subject of deposits, I have to deal with the objection, present I am sure in the minds of many of my hearers, that we pay interest on deposits. I am aware that many eminent bankers in the United States have expressed the opinion very decidedly that it is inconsistent with sound banking to pay interest on deposits. On the other hand, bankers in Great Britain and in Canada would say that any system of banking which will not afford interest on *certain classes* of deposits is unsound. I must hold with this latter opinion. It is entirely a question of the character of the deposit. Well managed Canadian banks do not give interest on active current accounts. But all Canadian banks issue interest bearing receipts, and, as you will have gathered, all, or almost all have Savings Departments. These deposits, great or small, are in the nature of investments by the depositor, and are not like the temporary balances of a merchant. They are entitled to interest. It is of vital importance to every nation that its people should have the saving habit. It is also of vital importance that all the money disbursed for labor, or to the farmer or otherwise, should find its way back as early as possible into the channels of commerce. Will it find its way back unless interest is offered for it? It will be said that the ordinary savings bank is the proper organization to take care of such deposits. So far as the very large cities are concerned this may be quite true. The mercantile banks of Chicago would not like to have been the creditors of the excited savings bank depositors who clamored for their deposits a few weeks ago. But is the ordinary savings bank an effective instrument for collecting the miscellaneous savings of the smaller communities? I think not. Be this as it may, we by our branch system, with the savings department added, provide in small towns where the ordinary savings bank is impossible, a secure place of deposit, and the quite large deposits of our leading banks are certainly the accumulation of tens of thousands of such depositors.

Banks are required once a year to make a return to the Government, which is published as a blue-book, of all unclaimed dividends, deposits or other balances of five years standing.

BANK INSPECTION.

We have in Canada no public bank examiner as in the United States, nor are our annual statements audited as in Australia. When the audit system was proposed, we resisted because we felt that it pretended to protect the shareholders and creditors, but did

not really do so, and if the audit did not really protect it seemed better that shareholders and creditors should not be lulled by imaginary safeguards, but be kept alert by the constant exercise of their own judgment. So far as we have ever discussed with the Government the question of public bank examiners, apart of course from denying the necessity for anything of the kind, we have confined our arguments to pointing out the impracticability when banks have many branches. This may in the minds of some constitute an argument against branch banking. I simply state the facts. But we say that, while it may be very well—if it really does lessen bank failures—to have public examiners for the protection of the people, it is much more necessary with branch banking to have bank examiners, or as we call them, inspectors, on behalf of the executive of the bank. And I am aware that the practice is growing in the United States, where everything is under one roof. When it comes to the quality of the work done by our inspectors, I would not admit that anything could well be better. In my own bank it takes a staff of five trained men an entire year to make the round of all the branches. Some of these officers devote themselves to the routine of the branches, verifying all cash, securities, bills, accounts, etc., testing the compliance of officers with every regulation of the bank, reporting on the skill and character of officers, etc., while the chiefs devote themselves to the higher matters, such as the quality of the bills under discount, loans against securities, indeed the quality and value of *every* asset found at the branch. They also deal with the growth and profitableness of the branch, its prospects, etc. Now all these matters have already passed the judgment of the branch manager, and the more important have been referred to and approved by the executive, so that it may be said that three different judgments are passed upon the business of the branch. But it will be said that the chief inspector may be under the sway of the executive and his reports a mere echo of the opinion of the latter. This is quite true—the reports may be dishonest. We do not tell the public that the inspector is specially employed for its protection. He, like the general manager, is merely a part of the bank's machinery for conducting business, and the public is left to judge of the bank by its chief officers, its record in the past, its *entourage*.

Our banks make a very full return to the Government at the close of each month. These are published during the month and

are keenly discussed by the public. The Deputy Minister of Finance has the power to call for statements of any character at any time.

In the larger banks the officers insure their fidelity by funds established within the bank. Many of the banks also have funds for the superannuation of their officers.

RESERVES.

If my paper were not already too lengthy I would like to have discussed the question of reserves. You will not perhaps be astonished to learn that we hold with the majority of the banking world outside of the United States against fixed reserves. With us no reserves are actually required by law. The cash reserve in gold and legal tenders has averaged for some years about ten per cent., but you will remember that our till money is almost entirely supplied by the bank note circulation. The smaller banks keep their available resources in securities, call loans at home and balances with their bankers in Montreal and New York. The large banks, as you know, in addition to their securities and call loans in Canada, lend largely on easily liquidated securities in the United States.

The change making notes, those of denominations less than \$5. are issued by the Dominion Government. The settlements at the clearing houses are made in legal tenders, notes of large denominations being issued by the Government for the purpose. Forty per cent. of whatever cash reserve a bank may keep must be in Dominion legal tenders, a provision entirely in the interest of the Government, and so unworthy of our otherwise creditable system that we must hope our Government will some day relieve us of such an unscientific arrangement.

